Lease Accounting Changes- Tax Response

Confidential Response from:

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Bona-fides

- Established in 1967, the British Vehicle Rental and Leasing Association is the UK trade body for companies engaged in the rental and leasing of cars and commercial vehicles. Its members operate a combined fleet of 4.5 million cars, vans and trucks.
- BVRLA members buy nearly 50% of all new vehicles sold in the UK, an estimated 1 million vehicles (including 308,000 UK-made vehicles) per annum.
- Collectively, members of the BVRLA support around 317,000 jobs and contribute over £24.9 billion to the UK economy each year.
- Through its members and their customers, the BVRLA represents the interests of over 2 million business car drivers and 10 million people per year who choose to rent a vehicle.
- As well as informing the Government and policy makers on issues affecting the sector, the BVRLA regulates the industry through a mandatory code of conduct, helping its members deliver safe, sustainable and affordable road transport to millions of consumers and businesses. For more information, please visit www.bvrla.co.uk

Executive Summary

1. The BVRLA welcomes the opportunity to comment on the discussion document and we are pleased to note that our constructive dialogue on this matter has provided HM Revenue and Customs (HMRC) with a progressive and constructive input on the proposals being considered.

2. As the industry body representing a membership that owns and operates over 4.5 million vehicles in the UK, we, the BVRLA and its members, welcome HMRC's review of how certain leases should be treated for tax purposes to help address the break in the link between the accounting and tax treatment for lessees adopting the new standard for lease accounting (IFRS16).

3. We encourage the Government to take this opportunity to modernise and simplify the existing corporation tax system and to demonstrate that it has a progressive world class tax system that reflects the realities of the business environment. Furthermore, we believe this supports the UK's investment strategy to continue to support the UK automotive sector.

4. It therefore makes sense to ensure changes accommodate both IFRS 16 and UK GAAP so it seems the most pragmatic and simple to move towards tax entries based on accounts prepared under all existing accounting regimes. Accounts of all but the smallest of business will be subject to audit, so the scope for mischief is limited.

5. UK vehicle leasing not only offers firms of all sizes in the UK access to some of the greenest, cleanest and safest vehicles, but in doing so UK leasing firms help to support the UK's automotive market by purchasing 80% of vehicles built and sold in the UK.

6. To assist the Government's review, we have provided spreadsheets which highlight existing issues, for example, the inability to claim 100% capital allowances on low CO2 vehicles, as well as highlighting potential discrepancies that the various options could create in terms of a level playing field.

7. We have modelled the four options, from both a lessor, UK GAAP lessee, IFRS lessee and outright purchase perspective, principally to show the consistency and timing of tax receipts under each scenario. In addition, we have added two further options, being lessor status quo and an accounting based regime, with no capital allowance for purchased assets. There are a number of assumptions made due to uncertainty around precisely how option 3 and option 4 will work in practice particularly for UK GAAP lessees. The modelling is attached (as spreadsheets) at Annex A and B.

Key Messages

Existing rules are outdated, in the case of high polluting cars impose disproportionately high cash flow disadvantages on vehicle lessors and need to be urgently reformed on a tax revenue neutral basis

For vehicle lessors, change the tax relief for the depreciation of motor vehicles so that the tax relief is aligned to accounts depreciation (including disposal profits and losses)

Vehicle Lessors

8. While lessors remain largely unaffected by IFRS 16, vehicle depreciation is the single biggest cost to a vehicle lessor and the deferral of corporation tax relief through the application of capital allowances adversely affects cash flow and can distort pricing strategies as lessors of different sizes and tax circumstances seek to offset this situation. Some members report that this can often mean tax relief is being sought for vehicles for a period of 20 years or more, long after the vehicle has been sold. As the CO2 thresholds applied to the capital allowances regime reduce this increasingly disadvantages lessors of passenger cars and this progression may not necessarily be offset by improvements in manufacturers' technologies.

9. Our Members therefore continue to face lengthy deferrals on the tax relief for expenditure on cars, especially those that fall into the special pool. The rules are penal to lessors who are simply fulfilling an order placed by their customers and we would suggest it would be far simpler and effective from a behavioural perspective point of view to follow the principle of the polluter, and only the polluter, pays. For example, the company car tax system is a key influencer on both the employee and employer as to the CO2 of the vehicle selected.

10. Having carefully examined all options, our Members have advised us of their preference for Option 2 from a compliance cost and market impact perspective. We recognise that such a move would remove the distinction between lower and high polluting cars in the tax computations of the lessors and therefore accept that there may still be a requirement to retain a tax disincentive for lessees of higher polluting cars. We also note and support the additional environmental incentive that could be made available via Option 3.

11. In the case of lessors of vehicles under finance leases this regime change would mean that such lessors would be taxed in future on their margin.

12. Specific considerations would need to be given to the tax treatments of impairment adjustments (both charges and provision releases).

Vehicle Lessees

13. While the majority of UK businesses will remain unaffected by IFRS 16, we are mindful that local accounting standards, such as UK GAAP, may over time follow the new lease standard. It is on this basis that any proposed changes should accommodate accounting entries for all existing and future accounting standards.

14. The logical way of achieving this is to let the tax relief follow the accounting entries

    For UK GAAP operating leases, the expenditure qualifying for tax relief are the lease rentals charged to P&L

    For UK GAAP finance leases the expenditure qualifying for tax relief are the depreciation (including disposal results) and interest charges relating to the capitalised asset

For IFRS 16 RoU assets the expenditure qualifying for tax relief are the depreciation (including disposal results) and interest charges. In respect of low value assets or leases less than 12 months the expenditure qualifying for tax relief would be the lease rentals expensed to P&L

15. If in the vehicle lessor's books there is no distinction between lower and high polluting cars we recognise that there may be a need to retain a tax disincentive for lessees of high polluting cars. Our preferred position is that this is already achieved through the company car tax (CCT BiK) and Vehicle Excise Duty (VED) regimes but if it is also felt necessary to continue with a disincentive in the corporation tax regime then this could be a continuation of the lease rental restriction or some other statutory adjustment to the tax relief available. To the extent the lease rental restriction is retained then we would expect this to be applied to the Right of Use (RoU) depreciation and lease interest expense under IFRS 16.

Transitional Rules

16. We are pleased to note that during our meetings with departmental officials, it was generally accepted that introduction of a new regime would have to be carefully phased in. It is on this basis that we believe that it would be helpful to provide our formal comments on the best approach and importantly to ensure that the new regime does not create any undesired market disruption or tax revenue distortion.

17. It is important that any new regime should be operative in parallel with the existing regime. By doing so, the compliance burden will be kept to a minimum as our Members will not be expected to carry out a complex and technical retrospective tax computations to their existing car fleet. In addition, this will remove any difficulties and disruption to our Members pricing models, which ordinarily would be used to calculate the monthly rental payments by their customers over the fixed duration of the lease agreement.

18. It would therefore seem appropriate for specific transitional rules to be applied so that it is clear that the new regime would only impact upon contracts starting with effect from a specific date should be subject to the new rules. In the case of vehicles, the start date is the date of delivery.

19. We also believe that it would be appropriate for relief to be given to the existing capital allowances pools over a shortened statutory period. This would alleviate the cash flow disadvantages previously referred to for the higher polluting cars and limit the numbers of years in which tax payers would have to operate two systems for calculating relief and assigning disposal proceeds to the correct pools.

Specific Questions

Option 1 – Status Quo

20. As we have outlined above, the current system of capital allowances does not fairly reflect the commercial realities for vehicle lessors.

21. The only merits of retaining the existing system would be that tax payers are generally familiar with the operation of the system. However, we do not believe this is sufficient justification for maintaining status quo. The current system is probably well enough understood

Option 2 – tax more closely follows the accounts

22. It is difficult to say what impact this change would have on financing decisions but if there is any change at all we would expect leasing rates to reduce, therefore supporting investment. It would depend how great the divergence of tax and accounting treatments were. If it is not great, then any additional burden should be manageable. Option 2 is simpler and gives a fairer outcome to vehicle lessors than the current regime

Option 3 – similar to option 2 + lease allowance

23. The introduction of a leasing allowance may help financing decisions but it depends on how beneficial the allowance is. We doubt that claiming the leasing allowance would present particular difficulties. In any event if individual users find the process too difficult they can either source appropriate professional help if the benefits are significant enough or decide not to elect for the leasing allowance otherwise

24. No leasing allowance where no right of use (RoU) asset is recorded. The concept of leasing allowance also needs to be applied to UK GAAP where there is no such thing as a RoU asset

Option 4 – Lessee claims the capital allowance

25. We doubt that many, if any, vehicle lessees would opt for tax relief through capital allowances instead of the current approach. This would simply result in a deferral of tax relief. We do not think capital allowances should be introduced for vehicle lessees and that tax relief for lease expenditure should be given as described in the Vehicle Lessees section above.

Closing Comments

26. We positively welcome the Government’s proposal to review and modernise the tax treatment of leases, which is patently in urgent need of review. Our Members preference for Option 2 and or 3 is based on the understanding that it will genuinely bring forward the desired deregulatory measure and ultimately lead to a reduction in the compliance burden on the affected businesses.

27. We specifically remain hopeful that these proposals will help alleviate our continued concerns that the timing of tax relief does not fairly reflect commercial realties.

28. We remain confident that this proactive style of working with industry and recognising the contribution it can offer will go some way towards securing the Government’s stated policy objective without compromising or damaging the competitiveness of UK plc. We believe that this partnership between Industry and Government will secure positive changes and help ensure that industry can safely be positioned to assist towards bringing about these changes.